ST 00-0173-GIL 08/24/2000 COMPUTER SOFTWARE

In Illinois, the transfer of canned computer software is subject to Retailers' Occupation Tax and Use Tax, regardless of the form in which it is transferred or transmitted. See, 86 Ill. Adm. Code 130.1935. (This is a GIL.)

August 24, 2000

Dear Xxxxx:

This letter is in response to your letter dated July 14, 2000. The nature of your letter and the information you have provided require that we respond with a General Information Letter, which is designed to provide general information, is not a statement of Department policy and is not binding on the Department. See 2 Ill. Adm. Code 1200.120 (b) and (c), which can be found on the Department's Web site at www.revenue.state.il.us/legalinformation/regs/part1200.

In your letter, you have stated and made inquiry as follows:

I am seeking information regarding the taxation of Application Service Providers in your state.

An Application Service Provider is a company that allows a software user to use the software on the Internet instead of buying a its own copy. For example, instead of a Illinois business buying a copy of the software and installing it on its own computers., it would instead connect to the Internet to access and use the software there. A recent news article described this type of software as follows:

> ***A second factor was that the makers of this software … promised a new generation of programs run entirely over the Internet. They said the upgrade would be profound because companies would be able to provide essential software to employees without the company ever having to configure their individual computers.***
>
> ***Rather, when employees wanted to file an expense form, check product updates, look into their retirement portfolio or contact suppliers, they would do so by logging into an Internet site on which all the information was kept. COMPANY said that it saved $1 billion on operating expenses last year by using its own Internet-based software internally,.***
>
> ***This shift to Internet-based software from so-called client-server based software -- in which some parts of the program are kept on a central server and some on individual computers -- signals a radical shift in the industry …***

I am also enclosing two recent articles about ASPs.

At this time, I would like to know how Illinois plans to treat ASPs for sales tax purposes. In particular, I would like to know:

(a) do you plan to tax this type of transaction;

(b) if so, under what theory (copies of any relevant statutes, regulations, administrative rulings, etc, would be appreciated); and

(c) does it matter if the ASP was located out of state.

I look forward to hearing from you.

The Retailers' Occupation Tax imposes a tax upon persons engaged in the business of selling tangible personal property at retail. A "sale at retail" is the transfer of ownership of, or title to, tangible personal property to a purchaser, for use or consumption and not for resale in any form as tangible personal property, for a valuable consideration. See the enclosed copies of 86 Ill. Adm. Code 130.101 and 130.201.

In Illinois, the transfer of canned computer software is subject to Retailers' Occupation Tax and Use Tax, regardless of the form in which it is transferred or transmitted. See the enclosed copy of Section 130.1935. As you can see from subsection (a) of this regulation, canned software that is transmitted electronically is specifically subject to tax.

Section 2-25 of the Retailers' Occupation Tax defines "computer software" as

> a set of statements, data or instructions to be used *directly or indirectly in a computer in order to bring about a certain result in any form in which those statements, data or instructions may be embodied, transmitted, or fixed, by any method now known or hereafter developed*, regardless of whether the statements, data or instructions are capable of being perceived by or communicated to humans, and includes prewritten or canned software that is held for repeated sale or lease, and all associated documentation and materials, if any, whether contained on magnetic tapes, discs, cards or other devices or media, but does not include software that is adapted to specific individualized requirements of a purchaser, custom-made and modified software designed for a particular or limited use by a purchaser, or software used to operate exempt machinery and equipment used in the process of manufacturing or assembling tangible personal property for wholesale or retail sale or lease. For purposes of this Act, computer software shall be considered to be tangible personal property. (See, 35 ILCS 120/2-25)(emphasis added).

Your letter does not contain sufficient information for us to make a specific ruling regarding ASP software transactions. However, we would preliminarily note that Section 2-25 of the Retailers' Occupation Tax Act clearly envisions that software transmitted electronically is subject to tax (" … in

any form in which those statements … may be transmitted …."). Subsection (a) of Section 130.1935 codifies this position ("Canned software is considered to be tangible personal property regardless of the form in which it is transferred or transmitted, including tape, disc, card, *electronic means or other media")*.

In addition, we also note that the statutory definition of "computer software" does not limit the taxation of software by the form or method by which the software is transmitted or used. As you recall, Section 2-25 of the Retailers' Occupation Tax Act states that taxable software includes a set of statements or instructions to be used "directly or indirectly in a computer in order to bring about a certain result." The language of Section 2-25 broadly states that the software can be used to bring about a certain result "by any method now known or hereafter developed …." Given these provisions, we are not prepared at this time to advise that the Retailers' Occupation Tax and Use Tax do not apply to the transfer or use of software which is accessed remotely and used interactively on users' computers.

As you can see, however, from subsections (a)(1)(A-E) of Section 130.1935, a license of software is not taxable, provided it meets the following criteria:

A) it is evidence by a written agreement signed by the licensor and the customer;

B) it restricts the customer's duplication and use of the software;

C) it prohibits the customer from licensing, sublicensing or transferring the software to a third party (except to a related party);

D) the vendor will replace another copy at minimal or no charge if the customer loses or damages the software (the Department has deemed a license to meet this requirement even if it does not contain a provision to this effect, as long as the vendor's records reflect that he has a policy of providing copies of software at minimal or no cost if the customer loses or damages the software); and

E) the customer must destroy or return all copies of the software to the vendor at the end of the license period (perpetual license agreements are considered to meet this requirement, even though no provision is included in the license requiring the return or destruction of the software).

We have based this letter upon the very general information in your letter regarding the nature of ASP transactions. We would be happy to reexamine our response upon provision of more detailed information.

I hope this information is helpful. The Department maintains a Web site, which can be accessed at www.revenue.state.il.us. If you have further questions related to the Illinois sales tax laws, please contact the Department's Taxpayer Information Division at (217) 782-3336.

If you are not under audit and you wish to obtain a binding Private Letter Ruling regarding your factual situation, please submit all of the information set out in items 1 through 8 of Section 1200.110 (b).

Very truly yours,

Jerilynn Gorden
Senior Counsel, Sales & Excise Tax

Enc.